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July 21, 2020

Filed Electronically

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Good Faith Determinations of Fair Value – File No. S7-07-20

Dear Ms. Countryman:

T. Rowe Price appreciates the opportunity to comment on the SEC's proposed rule under the Investment Company Act of 1940 (the "**1940 Act**") on valuation practices and the role of the board with respect to the fair value of fund investments (the "**Proposed Rule**").[1] We commend the SEC for its efforts to modernize the regulatory framework for fair valuation. As the proposing release points out, markets and fund investment practices have evolved considerably in recent years, advances in communications and technology have greatly enhanced the availability and timeliness of pricing information, and new technologies have developed to facilitate price discovery and greater transparency. The roles played by advisers, fund boards, accounting agents, third-party pricing services, and auditors have all evolved considerably as well, and we appreciate the SEC's attempt to craft a modern framework that can reflect these changes while remaining consistent with the principles underlying the 1940 Act. Most importantly, we appreciate the SEC's recognition of the important role that advisers and third-party pricing services can and often do play in the valuation process.

We do, however, have some concerns about how the Proposed Rule will work in practice, particularly with respect to the expectations around board reporting, the treatment of U.S. GAAP Level 2 securities as fair values, the SEC's expectations with respect to back-testing and calibration, the challenge process, and the potential interaction between the Proposed Rule and Rule 17a-7 under the 1940 Act on cross-trades. Our comments on each of these points are explained in more detail below.

Permitting the Assignment of Valuation to Advisers and Subadvisers

We strongly support the idea that fund boards ought to be able to assign fair value responsibilities to advisers. A fund board's role is typically one of oversight, with the adviser and third-party pricing services doing the day-to-day valuation work. By allowing fund boards to formally assign valuation responsibilities to advisers, while retaining its oversight role, the Proposed Rule appropriately recognizes that the current roles played by boards and advisers have protected – and will continue to protect – investors by addressing conflicts of interest with respect to fair valuation.

[1] Good Faith Determinations of Fair Value, SEC Release No. IC-33845 (Apr. 21, 2020), available :www.sec.gov/rules/proposed/2020/ic-33845.pdf.

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The SEC also recognizes, however, that introducing a formal assignment of fair valuation responsibilities in some cases might change the services provided by advisers and asks whether that would have implications for advisory fees. The answer will depend on the circumstances and the terms of the advisory agreements between the funds and advisers involved, but it is reasonable to assume that a formal assignment of valuation responsibilities could result in additional service demands and related costs and liability for an adviser, particularly with respect to private company valuations. This dynamic may play out differently in different situations. Consider, for example, two newly launched funds: one where the board assigns most fair valuation to an adviser but outsources the fair valuation of private securities to a specialized third-party pricing vendor, subject to direct board oversight; and one where the board assigns all fair valuation to the adviser. The adviser in the latter scenario bears the additional responsibility to value the private securities, and in negotiating the terms of its initial asset management contract may seek compensation for that additional work akin to the specialized third-party pricing vendor. That option may not be realistic with respect to an existing fund, where the board and the adviser may decide that the additional services are included in the existing fee, particularly in an environment where fee increases are not practical.[2]

We also support extending the board's ability to assign valuation to subadvisers, although we recognize there are additional complexities involved. T. Rowe Price Associates (TRPA) serves as the adviser to the Price funds. Although the Price funds do not utilize unaffiliated subadvisers, TRPA is a subadviser to external (non-Price) funds. Our perspective is thus both as an adviser that would likely have fair valuation assigned to it, and as a subadviser that may or may not be asked to take on fair valuation responsibilities. As a subadviser, before accepting such an assignment, we would want to fully understand: the role and responsibilities of the subadviser, adviser, and board; which entity is liable for valuations; the compensation for the additional work and liability (as discussed above); how the fund intended to reconcile any differences between advisers' prices on the same or similar securities; and how the fund's auditors would view those differences if not reconciled. That said, we support the flexibility in the Proposed Rule. To the extent that a fund's board, adviser, and subadviser(s) can satisfactorily address these issues, the rule should allow the board to assign valuation responsibilities as appropriate to its unique circumstances.[3]

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[2] Under our current arrangement, any fair valuation services performed by T. Rowe Price Associates, Inc. (TRPA) as the adviser to the T. Rowe Price funds are considered part of the overall advisory relationship and covered by the investment management contract between the Price funds and TRPA. There is no separate compensation for those services.

[3] In this regard, we note that the release seems to suggest that the board would assign fair valuation responsibilities to a subadviser only with respect to the investments in the portion of the fund's portfolio that is managed by that subadviser. To the extent that the rule allows assignment of fair valuation to a subadviser, it should be flexible enough to allow the board to delegate specific classes of investments (*e.g.*, all private company investments) to a particular adviser or subadviser, as opposed to limiting assignment to only the parts of the portfolio that each may manage. Although we think that may be an unusual scenario, we see no reason to limit the rule's flexibility in this regard.

Board Reporting

The Proposed Rule would require an adviser assigned valuation responsibilities, at least quarterly, to provide a written report to the fund's board containing an assessment of the adequacy and effectiveness of the adviser's process for determining the fair value, and to promptly report "matters associated with the adviser's process that materially affect or could have materially affected the fair value" of the assigned portfolio investments.

Several of our industry associations have recommended that the SEC consider a reporting framework that is more akin to those used in the 1940 Act for compliance reports (Rule 38a-1) or liquidity risk management (Rule 22e-4), pursuant to which the board would receive certain information that would be necessary to make the initial assignment decision, an annual report on the functioning and effectiveness of the fair valuation process generally, and quarterly reports on material changes or events relating to the assignment. Those initial and periodic reports would be supplemented by prompt reporting of significant lapses in an adviser's fair valuation processes, once discovered and verified. We strongly support these recommendations, as we think most of the valuation items in the proposed rule can be covered with the board annually and that material changes to valuation policies and procedures, significant deficiencies and material weaknesses in internal controls over financial reporting, and material net asset value ("**NAV**") errors can be presented to the board or audit committee on a quarterly or more frequent basis, as determined by the board.

We are concerned that, as outlined in the Proposed Rule and the release, the reporting could prove to be more burdensome than necessary to allow the board to fulfill its oversight responsibilities. The prescriptive nature of the detailed items that are subject to reporting requirements, and the frequency of the reporting, removes board discretion. We favor a more principles-based approach that identifies the types of information or subject-matters that should be considered to be reportable but leaves it to fund management, the fund board, and their respective independent counsels to determine the specifics of what is reported and when. This regime would be more consistent with the compliance and liquidity risk management frameworks, where the rules set the parameters for the types of information that should be reported to the board and when, and even the 15(c) process for the annual review of fund management agreements. In that context, which is arguably the most important function for the board, the information requested is largely a function of board and counsel discretion informed by SEC disclosure requirements regarding the 15(c) process.

We are particularly concerned about the way the Proposed Rule defines "prompt" with reference to three business days. It could take longer than three business days to verify whether a valuation issue is "material" enough to report to the board. In guidance, the SEC staff has used a concept of "reasonable diligence" when assessing foreign corporate actions and whether tax liabilities are material to a fund's net NAV. In its 1996 "Dear CFO" letter, the staff explained:

> Delayed recording of foreign corporate actions may be appropriate, however, if the investment company, exercising reasonable diligence, did not know that the corporate action had occurred. In this event, the investment company should record such action promptly after receipt of the information. Reasonable diligence would generally require an investment company to adopt appropriate procedures

> to obtain timely notification and verification of the effective date of the foreign corporate action.[4]

In a more recent letter relating to tax liabilities, the staff explained:

> Depending on the nature and extent of the tax issue, we recognize that this process may not be completed on the day that a tax issue is initially discovered. We do not believe, however, that it is appropriate to afford a specified period for a fund in performing its assessment of a potential tax issue, such as the 45-day period suggested in your letter. We expect a fund to exercise reasonable diligence in gathering the relevant information and to adjust NAV accordingly when a tax position does not meet the recognition criterion in Interpretation 48. [5]

We would encourage the SEC to consider incorporation of this concept of "reasonable diligence" into the final rule.

We are also concerned with the references in the Proposed Rule to "significant deficiencies" and "material weaknesses," which are a subset of the items intended to be promptly reported to the board. Both terms relate to financial reporting concepts defined in the auditing literature. By including them in the types of matters intended to be promptly reported, and by more generally requiring such prompt reporting to include issues that "could have materially affected" valuations (as opposed to those that actually did affect valuations), the SEC may have inadvertently expanded the concepts of material weakness and significant deficiency and added a requirement for funds to potentially speculate on valuations that could have been materially impacted.

At the very least, applying these financial reporting concepts does not seem practical in a daily NAV environment. For example, it is not unusual for a large asset manager that prices tens of thousands of securities daily to make frequent operational changes to improve controls and prevent errors. Some of these may result from immaterial pricing errors that, once detected, trigger changes in the control structure. The Proposed Rule would appear to require the adviser to discuss every such change, including those minor changes that had no material impact on valuation but "could" have had a material impact on valuation if the change was not made. This would not seem to be a good use of the board's time, particularly given the existing framework to report significant deficiencies and material weaknesses through the financial reporting process, which generally occurs semi-annually.

To address these concerns, we recommend that the rule require advisers to report material changes to policies and procedures, material valuation-related NAV errors, and material weaknesses and significant deficiencies in internal controls over financial reporting to the board or audit committee, and that board reports be made at the next meeting after such changes are made or such deficiencies are discovered. This both provides certainty in the universe of items

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[4] See https://www.sec.gov/divisions/investment/imltr110196.pdf.

[5] Letter to Fidelity Investments, Massachusetts Financial Services Company and OppenheimerFunds, Inc. re: Implementation of FASB Interpretation No. 48 (June 28, 2007), avail. at

https://www.sec.gov/divisions/investment/fin48_letter_062807.htm.

to report and allows for time to resolve the issue and include the corrective action taken in the report.

Aligning to GAAP Tiers

We appreciate the extent to which the Proposed Rule is intended to align more fully with concepts in U.S. GAAP, but we believe more can be done in this regard.

The most significant disconnect between the Proposed Rule and GAAP is a result of defining "readily available market quotation" to encompass only GAAP Level 1 securities. As the SEC explains in its economic analysis, about one third of all open-end fund assets are valued using GAAP Level 2 inputs, whereas only 0.2 percent of open-end fund assets are valued using Level 3 unobservable inputs. The Proposed Rule would treat both Level 2 and Level 3 securities as fair valued, subject to the same requirements.

The valuation risks and potential conflicts of interest between Level 2 securities and Level 3 securities are vastly different. Level 2 encompasses most evaluated prices on fixed income securities from independent third-party pricing services, where the valuations are based on observable inputs and the risk that the adviser might influence the valuation is minimal to non-existent. Although it may be difficult to classify these types of prices as "readily available market quotations" under the 1940 Act, the SEC should recognize that it need not apply the same set of fair valuation requirements to them as Level 3 prices, which are based on unobservable inputs, with greater opportunity for the adviser to use its subjective discretion.

Several industry associations have recommended aligning the Proposed Rule with GAAP's three tier system. We strongly support this idea, particularly with respect to the application of the recordkeeping requirements. The Proposed Rule would require funds to maintain "appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered." We understand the need to maintain appropriate documentation of fair value decisions, but we are concerned that applying this requirement could be extremely burdensome and provide little regulatory benefit in the context of evaluated prices on fixed income securities from third-party pricing vendors (the GAAP level 2 securities discussed above). For a fund complex the size of T. Rowe Price, there are thousands of level 2 securities with respect to which an adviser would have to maintain records of the specific methodology, assumptions and inputs used by the pricing service. A fund's policies and procedures should describe the methodologies and assumptions used by pricing services for specific classes or types of securities, and the fund's service providers can perform due diligence and other means to ensure that the pricing services are appropriately utilizing the methodologies in everyday pricing without the need to capture granular fair value documentation on each security.

While we are not wed to any one approach, we note that ICI recommends that the recordkeeping requirement in the Proposed Rule should take a bifurcated approach, treating prices received from pricing services differently than prices determined pursuant to methodologies unique to the fund or adviser. For pricing service prices, the fund would only need to maintain the prices received from pricing services and the basis for any adjustments that it may make to them. For other fair values, the fund would need to apply the more rigorous recordkeeping provisions that are in the Proposed Rule. We think this is a very reasonable approach, given the relative independence of the pricing vendor and the fact that it will itself maintain documentation to support its evaluation of prices. The recordkeeping provision in the

Proposed Rule is more appropriate where the adviser is exercising its own judgment in either overriding the vendor's evaluated price or determining the inputs for its unique methodologies.

Back Testing and Calibration

The Proposed Rule would require testing of the appropriateness and accuracy of the methodologies used to calculate fair value. In the release, the SEC explains that the decisions as to the frequency and types of specific tests to use are for the adviser and board to make, as they will depend on the circumstances of each fund. We completely agree. That same paragraph of the release, however, also expresses the SEC's belief that the results of back-testing and calibration "can be particularly useful in identifying trends, and also have the potential to assist in identifying issues with methodologies applied by fund service providers, including poor performance or potential conflicts of interest."

We would caution against over-reliance on back-testing and calibration, and we are somewhat concerned that the release establishes a SEC expectation that advisers will use these particular testing techniques. In our experience, facts and circumstances that come to light later may produce signals that are little more than red herrings. These false signals can complicate back-testing and calibration.

More specifically, while we recognize back-testing and calibration can be effective tools as described, there are many examples of where unforeseen macroeconomic or company specific developments arise which would nonetheless make a back-tested security price or calibrated model appear either understated or unreasonable. For example, previously used assumptions for an e-commerce company may not be relevant from a back-testing perspective if their business model suddenly gains an advantage. Similarly, calibrating a biotech company that discovers a novel breakthrough adds little to its unique fair value estimate. We appreciate that the Proposed Rule would allow room for judgment in the application of these tools, and we would hope that the SEC's interpretation and application of the rule will be similarly flexible.

The Challenge Process

The Proposed Rule would require a fund to establish criteria for initiating price challenges, and the discussion in the release suggests that this might involve establishing objective thresholds. At T. Rowe Price, as we believe is common throughout the industry, challenges are based on market judgement and insight, primarily from traders and portfolio managers or others on the investment teams. In that kind of environment, objective thresholds would be very difficult to define and apply. As the ICI points out in its comment letter,

> [T]he challenge process is dynamic and responsive to ever-changing facts and circumstances. For the Commission to require something more specific risks creating a sub-optimal price challenge process that would be both underinclusive (advisers could be prevented from challenging suspect prices that do not qualify under pre-set criteria) and overinclusive (advisers may feel compelled to challenge prices based on those criteria, even if they do not otherwise believe that the evaluated price is unreasonable, imposing burdens on the adviser and the pricing service).[6]

[6] *See* letter from the Investment Company Institute (July 16, 2020), at p.19, available at https://www.sec.gov/comments/s7-07-20/s70720-7433367-220249.pdf.

We agree, both with respect to ICI's explanation and its recommendation for the rule to require the establishment of a *process* for initiating price challenges, rather than specific *criteria* for initiating such challenges.

Cross Trades

In its comment letter, ICI recommends that the SEC should make it clear that Rule 2a-5 does not infringe on funds' current cross-trading practices under Rule 17a-7. ICI also recommends, more broadly, that the SEC pursue modernization of Rule 17a-7 more generally.

We agree with both of these recommendations. T. Rowe Price has actively participated in various trade association working groups and meetings with the SEC in recent years advocating for updates to Rule 17a-7 that would allow funds to rely on pricing service prices as an alternative to obtaining broker quotes for a broad range of fixed income instruments when setting the transaction price for the cross-trade (as opposed to the current framework that only permits the use of such prices for purposes of Rule 17a-7 when municipal securities are crossed). We are also in favor of updating the obligations on fund boards under Rule 17a-7 to align with SEC staff no-action letter relief, which allows a fund's chief compliance officer to report that the fund has complied with Rule 17a-7 for any cross-trades during the period.

We are pleased to see that a potential modernization of Rule 17a-7 is on the SEC's formal regulatory agenda, and we support the SEC's efforts in that regard. In the meantime, we would echo ICI's recommendation that the SEC clarify in any final fair value rulemaking that it is not intended to restrict current cross-trading practices.

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We thank the SEC for its consideration of our perspective. Please do not hesitate to contact us if we could be of further assistance.

Respectfully,

/s/	/s/	/s/
Bob Grohowski	Fran Pollack-Matz	Alan Dupski
VP & Sr. Legal Counsel,	VP & Sr. Legal Counsel	VP & Treasurer,
Legislative & Regulatory Affairs		T. Rowe Price Funds

cc: The Honorable Jay Clayton, Chairman
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison H. Lee, Commissioner
Dalia Blass, Director, Division of Investment Management